Real Estate in 1961

REAL ESTATE IN 1961

A Forecast
For Subscribers To

The Real Estate ANALYST

by

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ROY WENZLICK RESEARCH CORP.
REAL ESTATE ECONOMISTS, ANALYSTS & FINANCIAL PUBLISHERS

The Real Estate ANALYST

JANUARY 1
1961

Volume XXX

Number 1

As I see

THE OUTLOOK FOR REAL ESTATE IN 1961

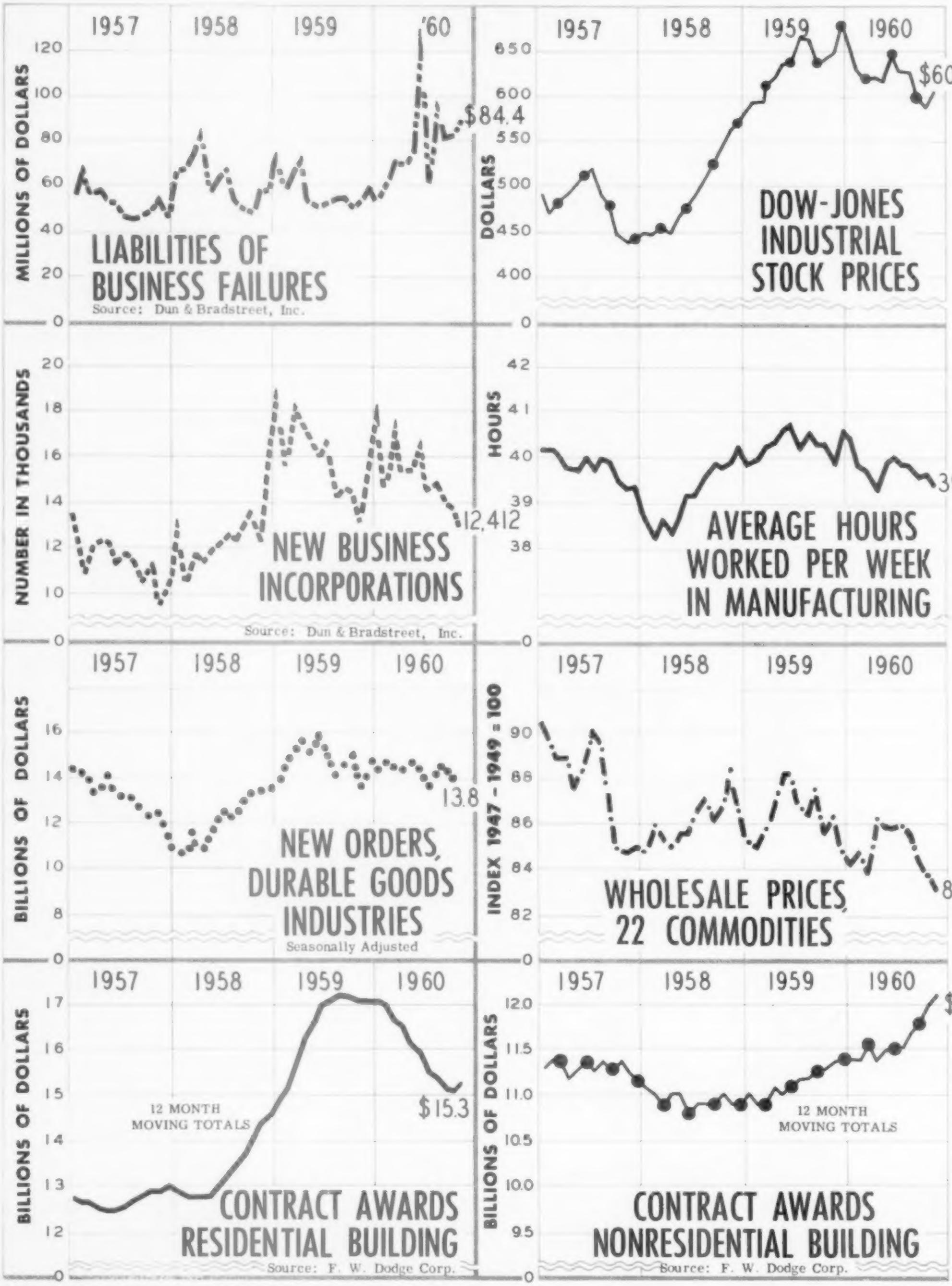
THE political oratory of a few months back about building two million dwelling units per year now looks silly in retrospect. The 1960 figures on the revised basis will probably total about 1,265,000 private and public nonfarm starts. The most optimistic forecast I have seen thus far on the 1961 prospects is that we may increase this by 5 percent. The most pessimistic forecast at the present time is my own -- that we will probably not exceed, and will probably fall below, in 1961, the number of new dwelling units we built in 1960.

I believe that the principal difficulty in the building field is not tightness of money nor high interest rates. I am certain that money will be easier to secure in 1961 than it is now and that interest rates will be very slightly lower. The difficulty is primarily a problem of inventory and of lack of confidence. In other words, it seems to me that in the past few years we have been building more rapidly than the market could absorb, with the result that it has become increasingly more difficult to sell houses in the market.

If I thought that the general outlook for business would improve rapidly in 1961, I might believe that the demand for housing would also increase to the point where we could readily sell more new dwelling units than we have in the past year, but I see nothing in the current figures that would lead me to believe that general business is now poised for a rapid improvement. The most optimistic forecast I have seen from any well-informed source is that the upturn may occur after the first quarter of 1961. More forecasts are placing the start of recovery after the middle of 1961, and some are placing it toward the end of the year. Those who expect an early upturn cannot show much in the way of statistical background for their optimism. Many of the early turning barometers are still pointing down, and until a number of these barometers show marked improvement, it is anybody's guess on when the recovery may start.

For many years, economists at the National Bureau of Economic Research have been studying ways to measure business cycles. This study has led them to believe that the fluctuations in general business activity are made up of separate fluctuations in each sector of the economy. At any moment in time some sectors of the economy are enjoying rising sales, others are suffering falling sales, some are just reaching a peak in sales, and others are reaching

① LEADING INDICATORS



their low and will soon see increased activity. Out of this confusion the National Bureau developed reference cycles based on the percentage of these statistical series reaching highs and lows. Thus, the peak in the level of general business activity comes when the most sectors of the economy are reaching theirs. The low in the level of general business activity comes when the most sectors are also reaching their lows.

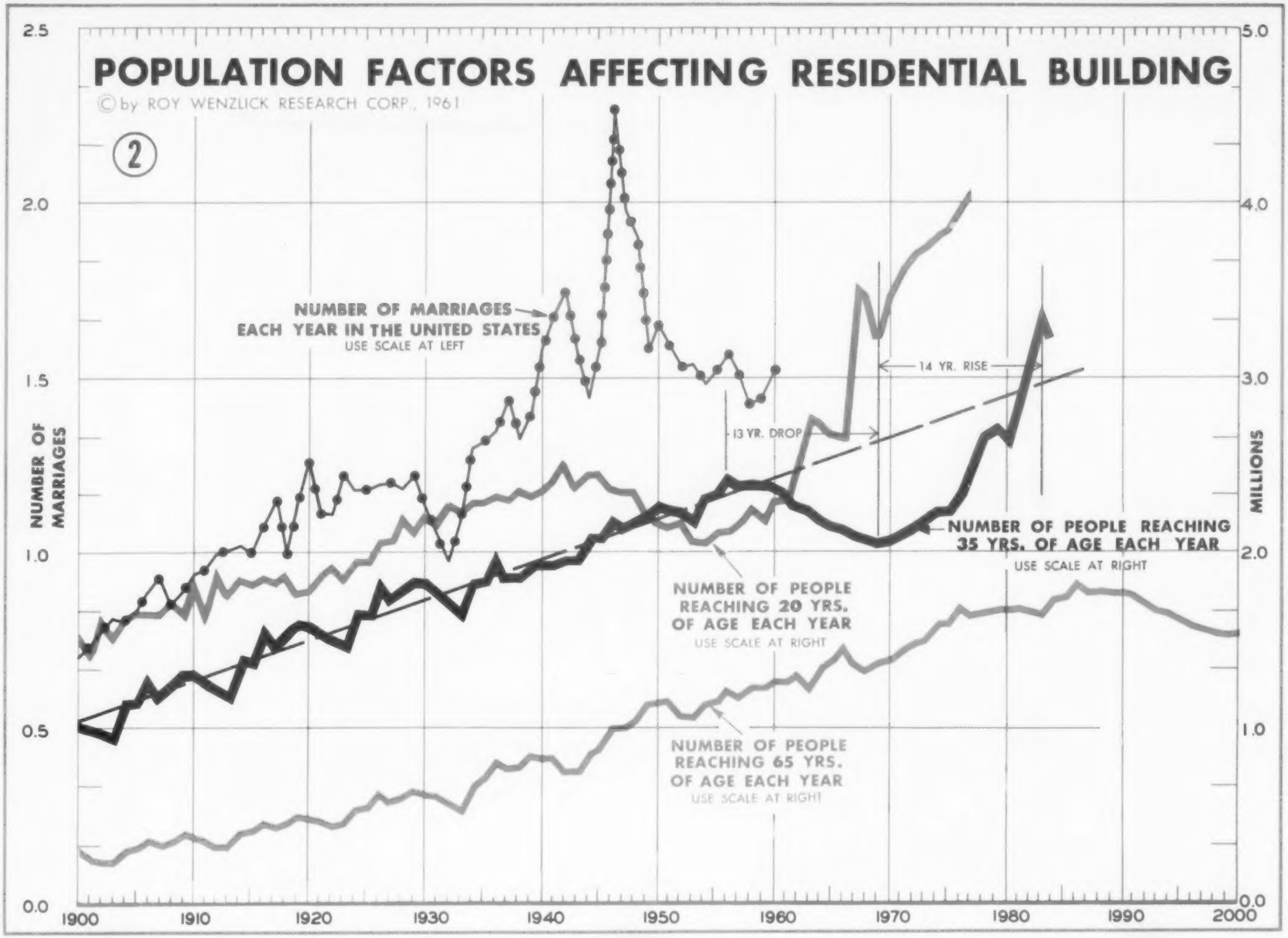
If activity in some sector consistently turned down before the rest of the economy, we could keep tab on that sector and predict the swings in economic activity. It would be particularly useful if that sector would always turn down or increase a certain number of months before the rest of the economy. In addition, it would be necessary for the actual statistics to be gathered and published before the rest of the economy reached its low or peak.

In evaluating over 400 statistical series of the economy, the National Bureau of Economic Research did not find any series meeting the criteria of the above perfect forecasting indicator. Many series, however, were found usually to lead general business, others usually coincided with the ebb and flow of general business, while another group of statistical series usually lagged behind general business. Any one of the leading indicators is not reliable because each cycle is different and any one of the leading indicators may lag or be coincident with the general level of activity. The importance of these leading indicators, then, is in their cumulative effect.

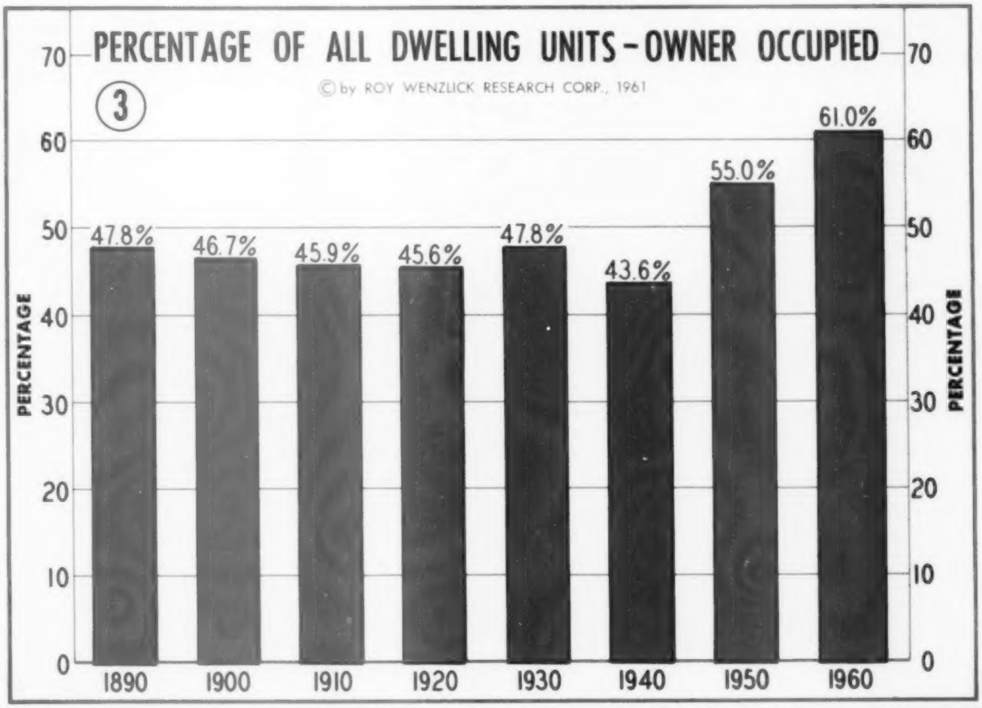
On the page opposite we have charted eight of the more reliable leading indicators. As more and more of these show a reversal in trend, it indicates that the general economy is more likely to also have a reversal in trend at some unspecified time in the future. For example, average hours worked per week in manufacturing started falling in July 1959; new orders to the durable goods industries began decreasing in July 1959; wholesale prices began falling in July 1959; the value of residential building contracts started its descent in October 1959; stock prices fell in January 1960; and the liabilities of business failures increased (worsened) in February 1960. New incorporations began a false decline in February 1959, and again turned down in February 1960. The only indicator not turning down is the value of nonresidential building contracts. Although the last index has not turned down, general business began its slide around July 1960.

These indicators would generally lead an upturn in the economy as well as a downturn. At this point, however, there is no hint of an upturn in the near future on the basis of these indicators, which have in the past led general business by an average 2 to 11 months.

In addition to the general business factors mentioned above, population statistics have not been entirely favorable from the standpoint of the home builder. Chart 2 shows the number of persons reaching certain given ages each year in our population from 1900 to 2000. It will be noticed on this chart that


POPULATION FACTORS AFFECTING RESIDENTIAL BUILDING
© by ROY WENZLICK RESEARCH CORP., 1961
2
NUMBER OF MARRIAGES
MILLIONS
NUMBER OF MARRIAGES EACH YEAR IN THE UNITED STATES
USE SCALE AT LEFT
NUMBER OF PEOPLE REACHING 35 YRS. OF AGE EACH YEAR
USE SCALE AT RIGHT
NUMBER OF PEOPLE REACHING 20 YRS. OF AGE EACH YEAR
USE SCALE AT RIGHT
NUMBER OF PEOPLE REACHING 65 YRS. OF AGE EACH YEAR
USE SCALE AT RIGHT
13 YR. DROP
14 YR. RISE
0.0
0.5
1.0
1.5
2.0
2.5
0.0
1.0
2.0
3.0
4.0
5.0
1900
1910
1920
1930
1940
1950
1960
1970
1980
1990
2000

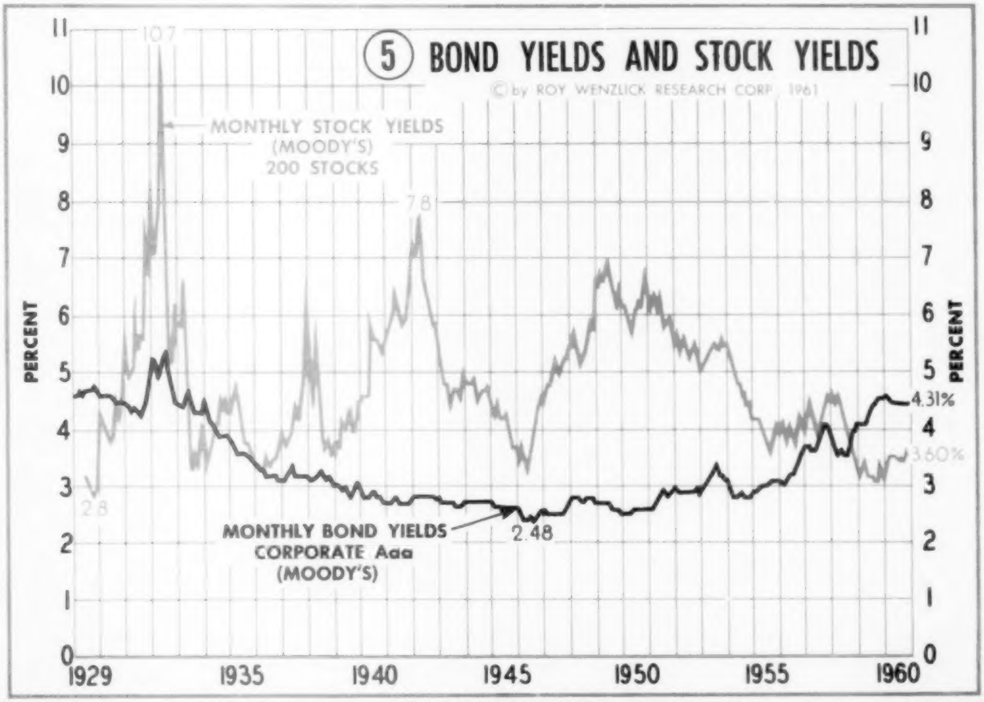
after 1960 we will experience a rapid increase in the number of persons reaching 20 years of age each year, and that by 1977 this number will be almost exactly twice the number reaching that age in 1954. The big rises will come in the early 1960's and in the late 1960's, with a third rise starting in 1969 and running through most of the 1970's. This, together with the rapid increase in the number of persons reaching 65 years of age, will constitute a strong stimulant to the market for multiple dwelling units. As a rule, 20-year-olds are not home buyers. They either increase the size of the family of their parents by continuing to live at home, or else they are renters until such time as they acquire some assets and reach earning levels sufficient to justify the purchase of a single-family residence. All of the statistics which we have been able to accumulate would indicate that the average age of home buyers is around 35 years, and while these figures would seem to indicate that this age has dropped by about one year in the past ten years, there is no indication as yet that younger people in large numbers will constitute the bulk of persons purchasing houses. Chart 2 shows that the number of persons reaching 35 years of age each year hit its peak in 1956, and that it will reach its lowest point in 1969, followed by a 14-year rise, bringing it to another peak in 1983. The maximum drop from 1956 to 1969, however, is only about 16 percent, and the drop from 1956 to the present is almost negligible. This factor by itself, therefore, is not responsible for the drop in new building, but any influence which it may have in the near future will be negative rather than positive.

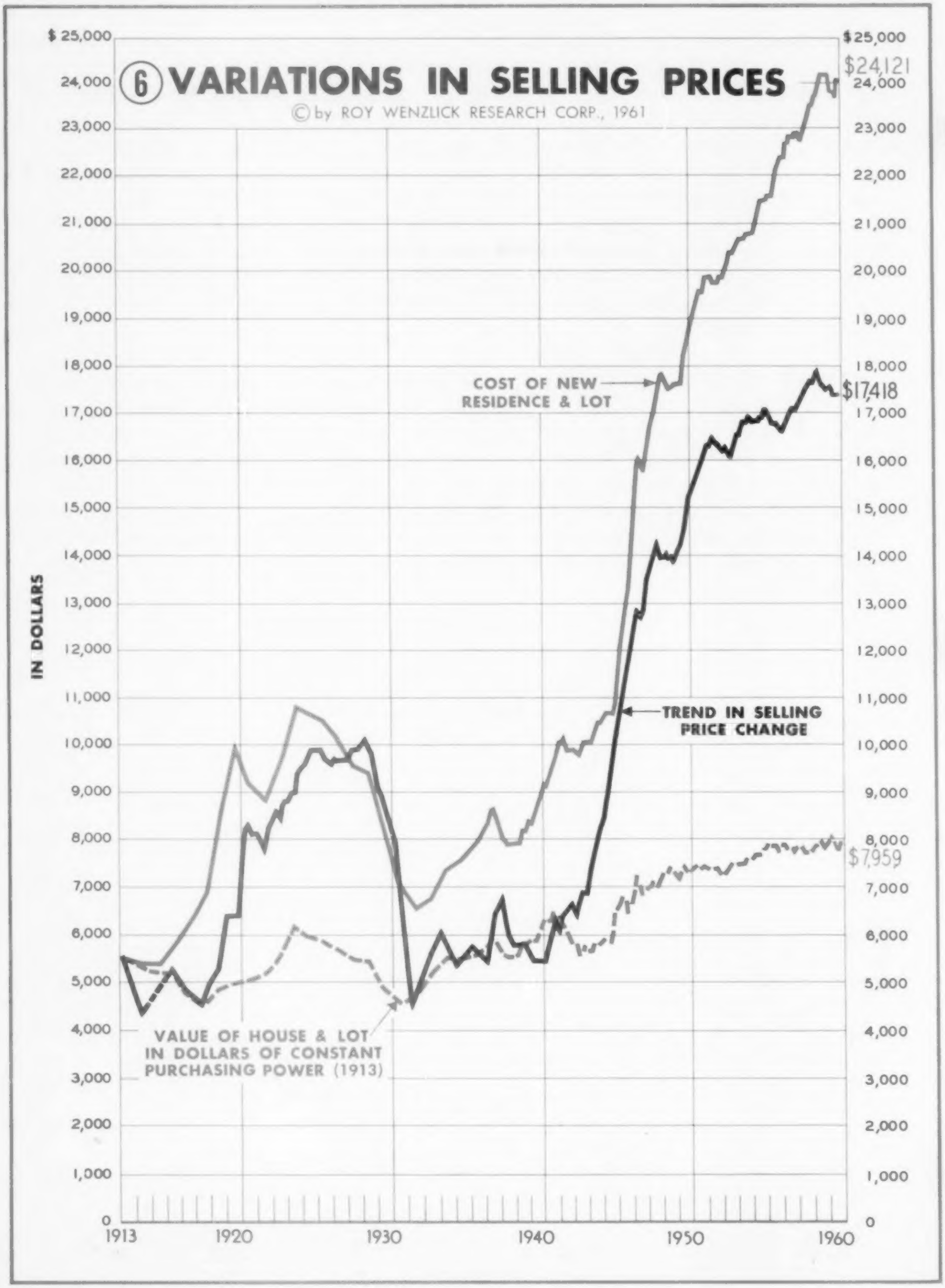


④ COMPARISON OF THE DOW-JONES INDUSTRIAL AVERAGE OF COMMON STOCK TO THE SELLING PRICE OF A TYPICAL SINGLE-FAMILY RESIDENCE

This same chart shows the number of marriages each year in the United States. From 1946 to the present there has been a rather consistent downward movement. While there may be some question as to whether this downward movement has stopped, I see nothing in the outlook for 1961 which would bring about any rapid rise in the number of marriages. Fluctuations in the marriage rate are influenced considerably by fluctuations in business conditions, and from that standpoint the marriage rate can be taken as a sort of index of confidence in the future. Marriages increasing rapidly are the result not only of increasing population of marriageable ages, but of a willingness on the part of the younger generation to accept the financial responsibility which marriage entails. If business conditions are uncertain, many prospective marriages are temporarily postponed.

Chart 3 shows the percentage of all dwelling units owner occupied, since 1890. It will be noticed that this percentage has constantly increased, until now more than three out of every five families own their own home. From the standpoint of the stability of our economy, this is fine. Clearly, a home-owning family has a bigger stake in its community and will have a more conservative attitude on problems involving its economic well-being than a non-home-owning family. It will also spend more on maintenance and modernization than a renting family. Expenditures for this purpose in 1961 will increase in spite of business conditions.





6 VARIATIONS IN SELLING PRICES
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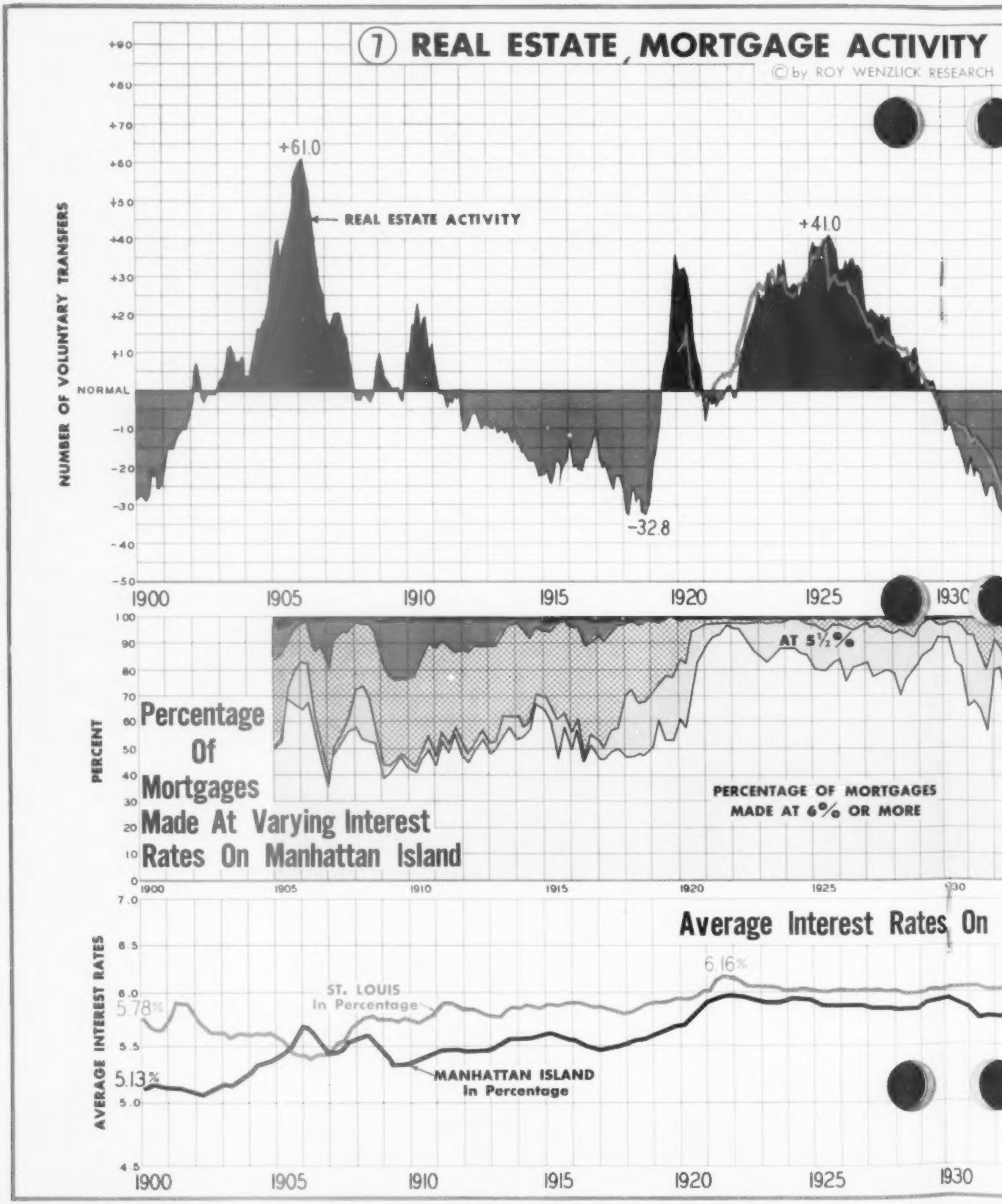
IN DOLLARS
COST OF NEW RESIDENCE & LOT
TREND IN SELLING PRICE CHANGE
VALUE OF HOUSE & LOT IN DOLLARS OF CONSTANT PURCHASING POWER (1913)
$24,121
$17,418
$7,959
$ 25,000
24,000
23,000
22,000
21,000
20,000
19,000
18,000
17,000
16,000
15,000
14,000
13,000
12,000
11,000
10,000
9,000
8,000
7,000
6,000
5,000
4,000
3,000
2,000
1,000
0
1913
1920
1930
1940
1950
1960

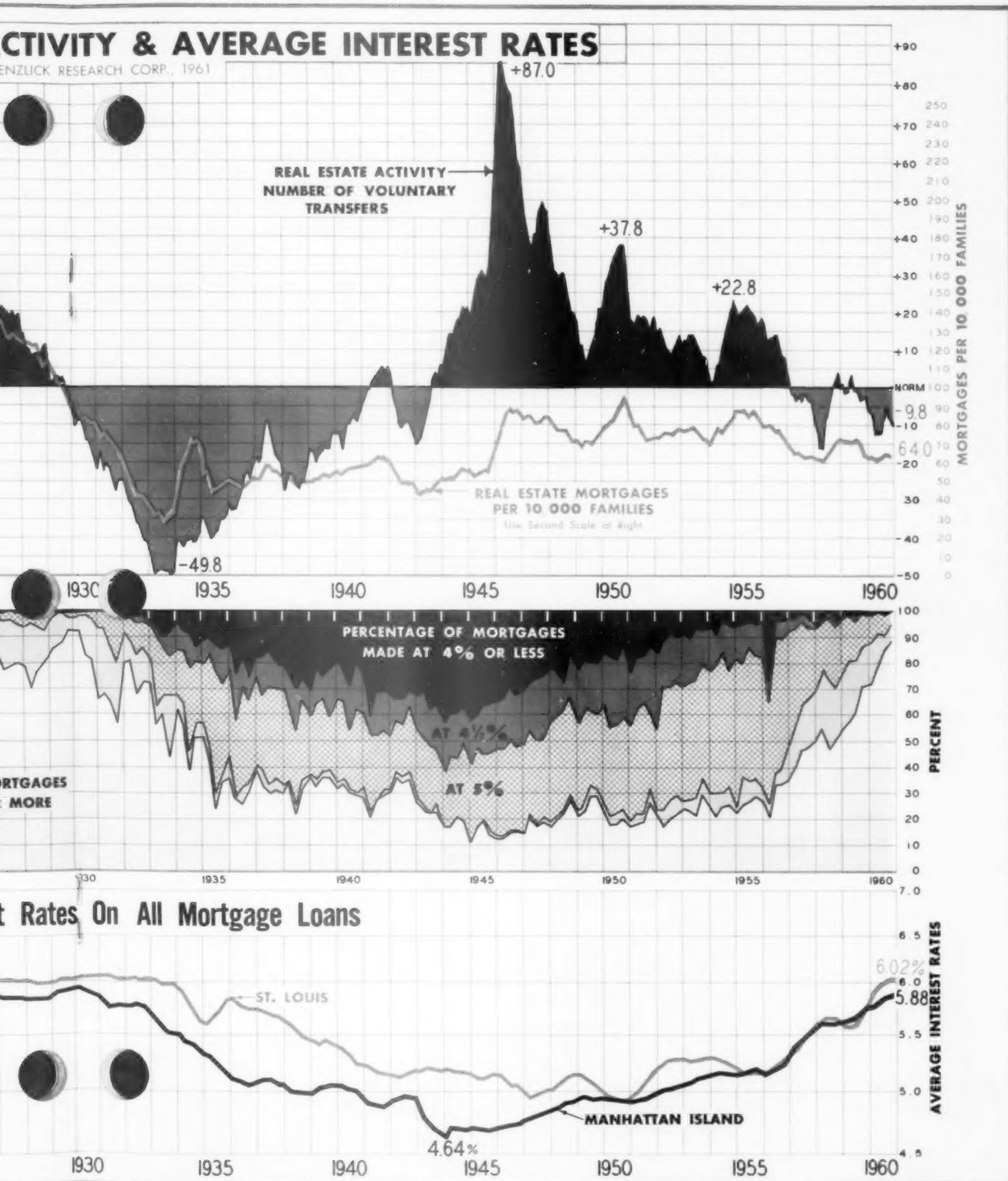
Undoubtedly a part of the rise in home ownership since the 1930's has been due to the increasing popularity of the small downpayment, monthly pay-off loan. This has tapped a market formerly unable to buy, but it is hard to see how this market, which has now been pretty well saturated, can show much further rapid advance. The rapid increase in the younger age groups will, I believe, during the next 10 years slow down the trend toward a greater percentage of home owners.

One other factor which seems to me quite important at the present time is the question of the soundness of today's values of common stocks. Chart 4 shows the fluctuations in the Dow-Jones industrial average from 1919 to the present in contrast with the fluctuations in the selling price of a typical single-family residence. The big inflation in stock market prices from 1926 to 1931 is apparent on this chart, as is the inflation from 1954 to the present. While I would not expect the average Dow-Jones price to return to anything like the level indicated by the selling price of a typical single-family residence on our chart, I still think that the stock market is badly overinflated, and this thought is borne out by chart 5. On this chart we have compared the yield of Aaa corporate bonds with the yield of 200 common stocks. Theoretically, the bondholder has far greater security than the owner of common stocks. He has the first claim on income and, in case of failure, on the assets of the corporation. The claims of stockholders can only be taken care of, either on interest or principal, after the bondholders have been paid in full. This chart would indicate that over the greater part of the last 32 years, investors have realized this situation. Because of the greater safety, bondholders were willing to accept a smaller return on their investment than were the owners of common stocks. Only in three short periods was this not true. Prior to the fall of 1930, stocks paid a smaller return than bonds, followed by a violent reaction where within a three-year period the return on the selling price of stocks increased from 2.8 percent to 10.7 percent, an increase in earnings in relationship to selling price of more than three and a half times. In 1933 and the first part of 1934 stocks again paid a lower return than bonds, but this was due to another reason. In this period the drastic economic depression had scared boards of directors to the point where even though earnings were available, relatively little was paid out in dividends. From that time until the latter part of 1958 stocks paid a higher return than bonds, but from 1958 on investors, afraid of inflation, have bid up the prices of common stocks until again they showed a yield considerably below the yield on Aaa bonds. The declines we have had thus far in the market are not nearly sufficient to return stock yields to a point above the yield on bonds. While undoubtedly the yield on bonds will decline slightly in the period ahead, it will not, in my opinion, decline enough to justify the earnings on common stocks at anything like their present selling price.

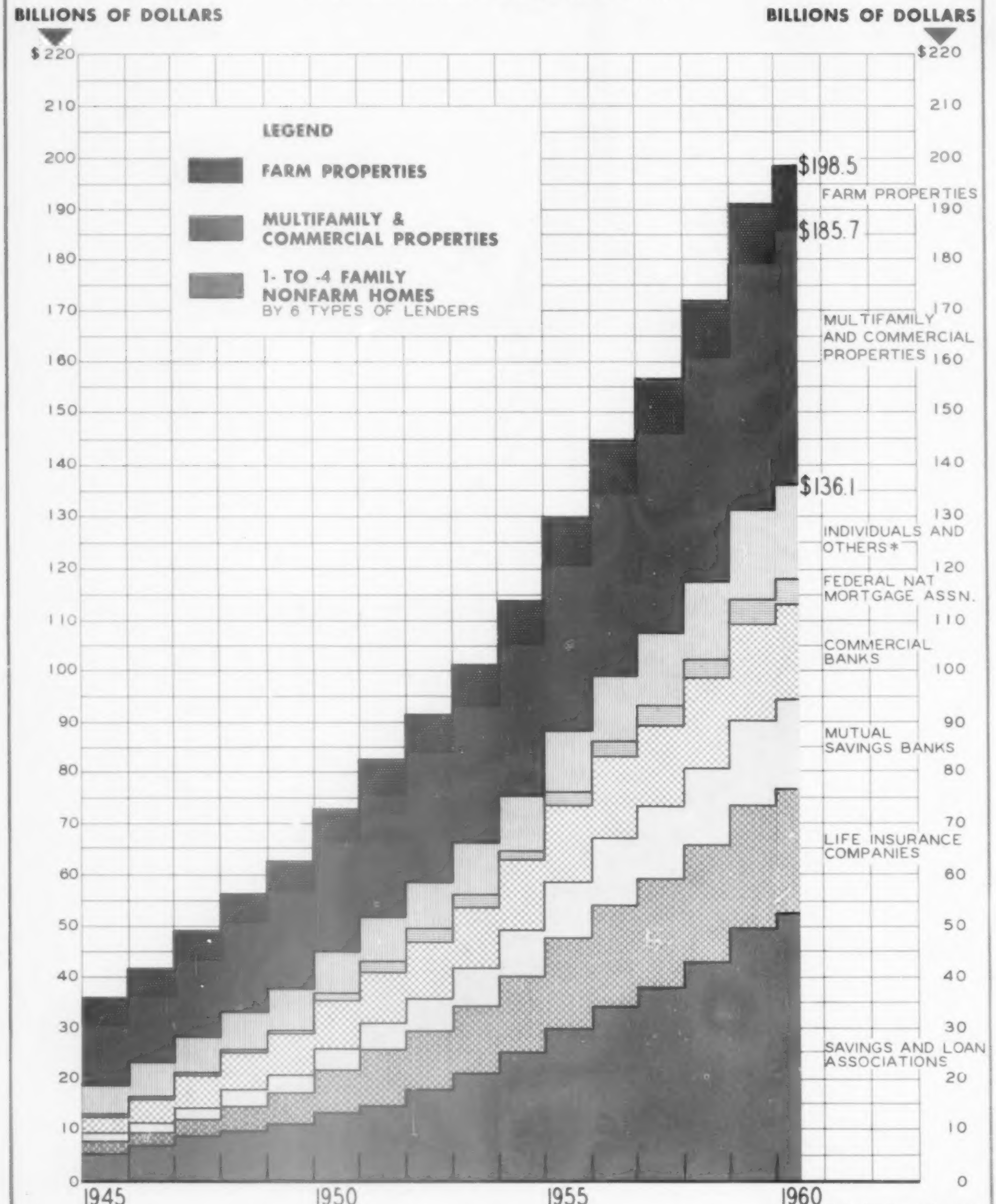
In the 33 years that I have been trying to outguess the future, I think I have made more mistakes by believing that some irrational situation could continue than I have by assuming that within a reasonable period a large enough per-



7 REAL ESTATE, MORTGAGE ACTIVITY
© by ROY WENZLICK RESEARCH
NUMBER OF VOLUNTARY TRANSFERS
NORMAL
+61.0
REAL ESTATE ACTIVITY
+41.0
-32.8
PERCENT
Percentage Of Mortgages Made At Varying Interest Rates On Manhattan Island
AT 5½%
PERCENTAGE OF MORTGAGES MADE AT 6% OR MORE
AVERAGE INTEREST RATES
Average Interest Rates On
6.16%
ST. LOUIS In Percentage
5.78%
5.13%
MANHATTAN ISLAND In Percentage

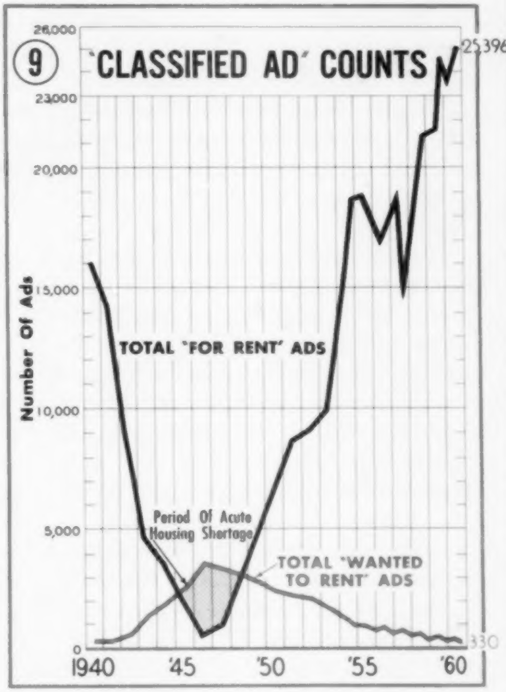

CTIVITY & AVERAGE INTEREST RATES
ENZLICK RESEARCH CORP., 1961
+87.0
REAL ESTATE ACTIVITY
NUMBER OF VOLUNTARY
TRANSFERS
+37.8
+22.8
-49.8
-9.8
64.0
REAL ESTATE MORTGAGES
PER 10 000 FAMILIES
MORTGAGES PER 10 000 FAMILIES
NORM
1930
1935
1940
1945
1950
1955
1960
PERCENTAGE OF MORTGAGES
MADE AT 4% OR LESS
AT 4½%
AT 5%
RTGAGES
MORE
PERCENT
t Rates On All Mortgage Loans
ST. LOUIS
MANHATTAN ISLAND
6.02%
5.88
4.64%
AVERAGE INTEREST RATES

8 MORTGAGE DEBT OUTSTANDING



*(Includes Home Owners Loan Corp. from 1945 through 1950.)

centage of people would return to a rational outlook. While, of course, this irrational relationship, as shown on chart 5, may continue for a while longer, it seems to me that within the not too distant future, stock yields should be above the yields on Aaa bonds. This would mean a further sizable drop in the Dow-Jones average.



A drop of this sort to me would be a return to normalcy, but unfortunately it would be a tremendous shock to those persons who have counted on the stock market as a hedge against inflation. Repercussions would not increase confidence, and again would be a further depressant of general business.

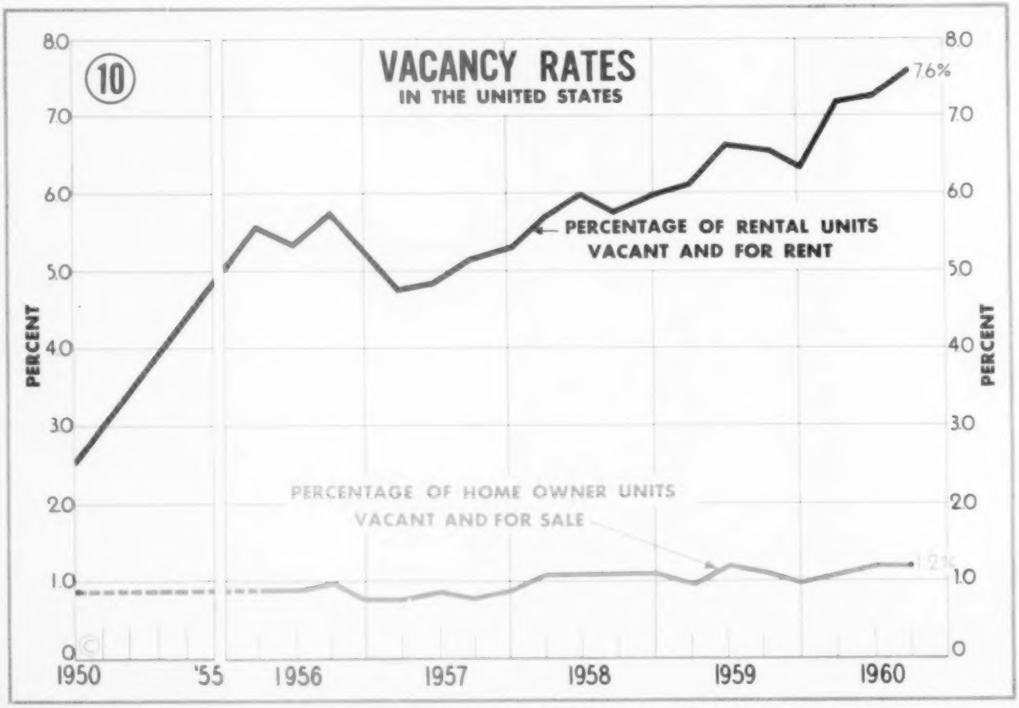
Chart 6 shows the relationship between replacement cost new of a typical six-room frame house on a suitable lot and the change in selling price of an existing building of a somewhat similar sort. In spite of the big increases during the 1940's and 1950's, the inflation in these figures is totally different from the inflation in the stock market. This is shown by the broken red line, which shows the value of the house and lot in dollars of constant purchasing power. It will be noticed on this chart that since 1946 there has been relatively little change in selling price in constant dollars. The big inflation has been the price increase caused by the drop in the value of the dollar. In other words, from 1946 to the present the real estate boom, unlike the stock market boom, has not been a boom at all but has merely been a readjustment in price to compensate for the cheaper dollar. Chart 5, showing stock and bond yields, clearly indicates that this has not been the situation in the stock market. Any inflation due to the cheapening of the dollar would affect not only the selling prices of stocks but their dividends as well, and on this basis both sides of the equation would be inflated. The fact that stock yields are still below bond yields would to me indicate that the stock market is much too high.

In a choice at the present time between the purchase of a single-family residence and a good common stock, I would pick, for the average family, the single-family residence. While I think there is some possibility that selling prices of existing buildings may decline for a short period, I think the decline will be slight, and that the recovery which will follow will carry prices back to approximately their present level or above.

The double spread, chart 7, shows the real estate cycle as computed by our organization, the number of real estate mortgages per 10,000 families, and the mortgage interest rates on Manhattan Island and in St. Louis. The Manhattan Island rates can be considered for all practical purposes to be the rates on larger buildings. The St. Louis rate is largely made up of mortgages on single-family residences, and I believe would be typical of those rates in most cities.

It is hard to ignore on this chart the cyclical nature of real estate activity. This is still more apparent if the chart is carried back another 75 years. Periods of high activity in real estate have been followed by periods in which real estate was lower. Frenzied booms have been followed by periods in which real estate investments were largely frozen and hard to liquidate. The top of the last boom was reached in 1946. The period from that time to the present has shown a gradual but persistent downward movement in the rate of transfers in relationship to families. We have probably not yet reached the point where a strong upward movement can be expected.

Chart 8 shows the amount of all mortgage loans outstanding by type of properties and by type of lenders. This chart shows mortgage indebtedness in the United States has increased from about $35 billion in 1945 to more than $198 billion in 1960. During this period indebtedness on one- to four-family dwellings increased by more than seven times, while all other mortgages in-

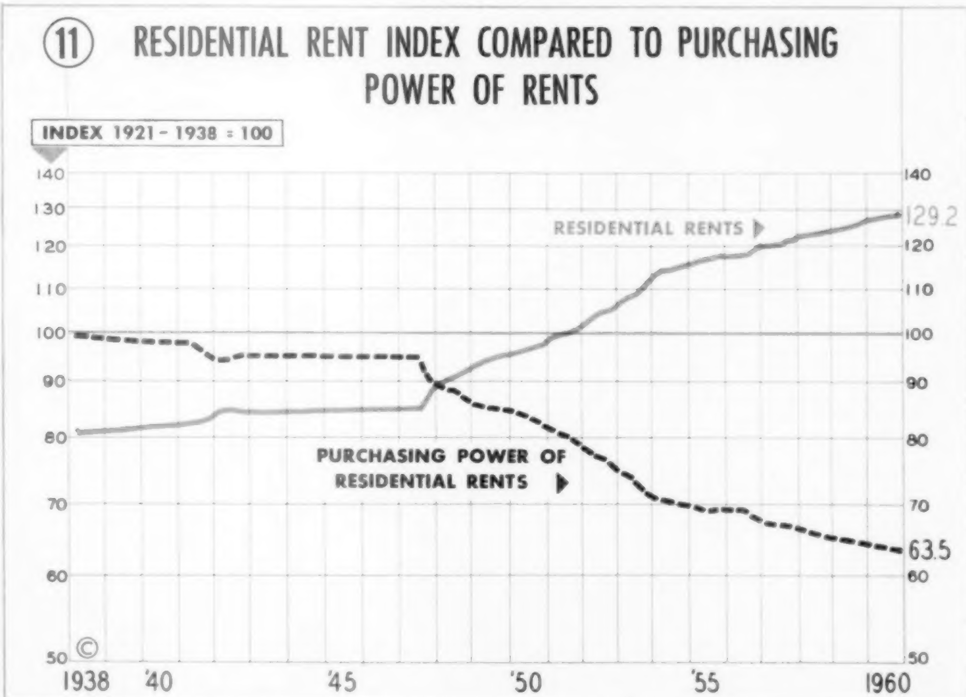


creased at just about one-half of that rate. During 1961 the increase in mortgages will be less than the increase last year.

Chart 9 shows a comparison of "For rent" and "Wanted to rent" ads in 38 metropolitan areas. The rapid increase in the number of "For rents" is the result of the relatively large building volume of the last few years, particularly in multifamily buildings.

Chart 10 shows residential vacancy rates in rental units and home owner units, vacant and for sale. Vacancy rates in rental units have been climbing rather consistently since the first quarter of 1957 and will continue to climb in 1961. The large increase expected in the number of persons in the younger age group should prevent vacancy rates in rental units from becoming excessive unless the general business situation should deteriorate to the point where a good deal of doubling up would take place.

Chart 11 shows the fluctuations in residential rents from 1938 to the present, both in dollars and in purchasing power. This chart clearly shows that while residential rents have been creeping up year after year, the increase has not been sufficient to offset the drop in the purchasing power of money. As a result, the purchasing power of rents today is only 63½ percent of what it was in 1938. The purchasing power of rents will decline further by a very small amount in 1961. Measured against the general price level, construction costs,

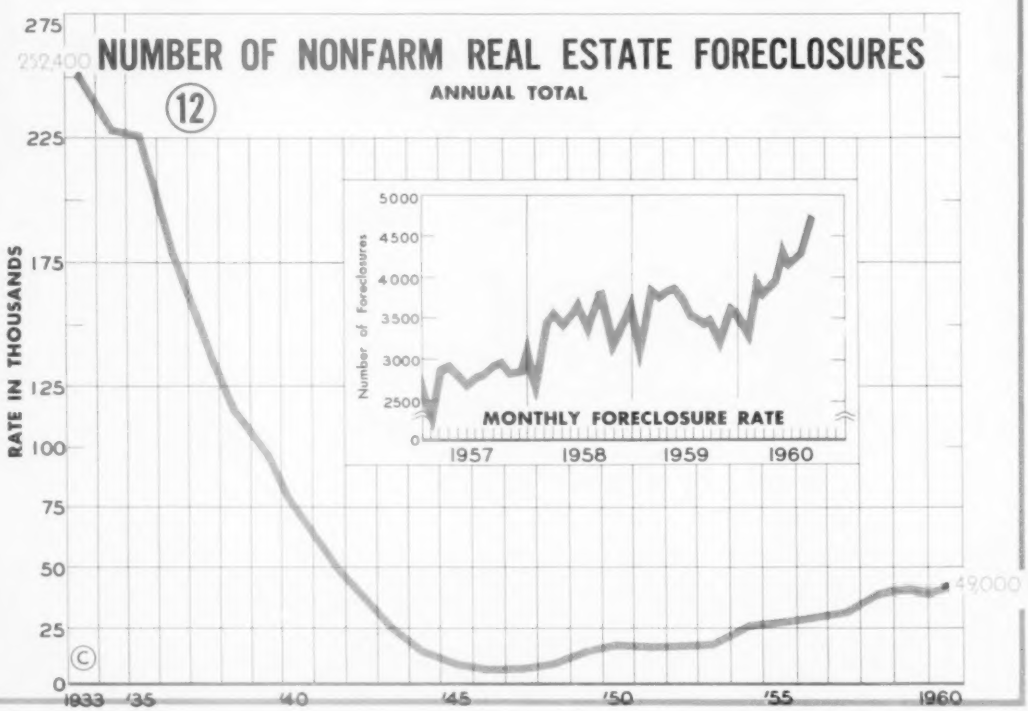


the selling prices of single-family residences, or almost any other similar index, residential rents are still quite low.

Chart 12 shows the number of nonfarm real estate foreclosures. While foreclosures as shown on this chart have been increasing and are now approximately double what they were in February 1957, I think that the further upward movement in 1961 will be slight, and that the chance of any great epidemic of foreclosures at any time in the foreseeable future is not great. For a further discussion of the foreclosure situation, see 1960 bulletin number 57.

Chart 13 shows housing starts in all metropolitan areas of the United States classified by size of area. The areas having from half a million to one million population have been building consistently at a higher rate than other sized areas. Those metropolitan areas with less than 250,000 people have generally built at a much lower rate.

On pages 20 and 21 we show new construction expenditures as estimated by the Department of Commerce for 1961 in comparison with actual expenditures in the years back to 1945. It seems to me that these forecasts will err on the high side, as I expect slightly less construction in 1961 than these figures would show.



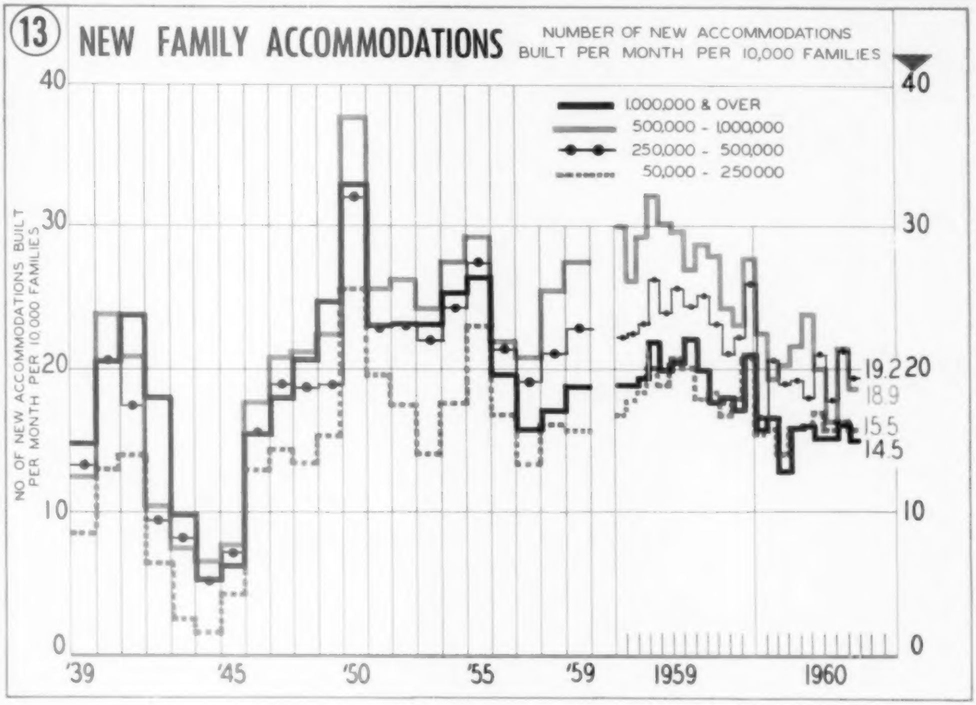
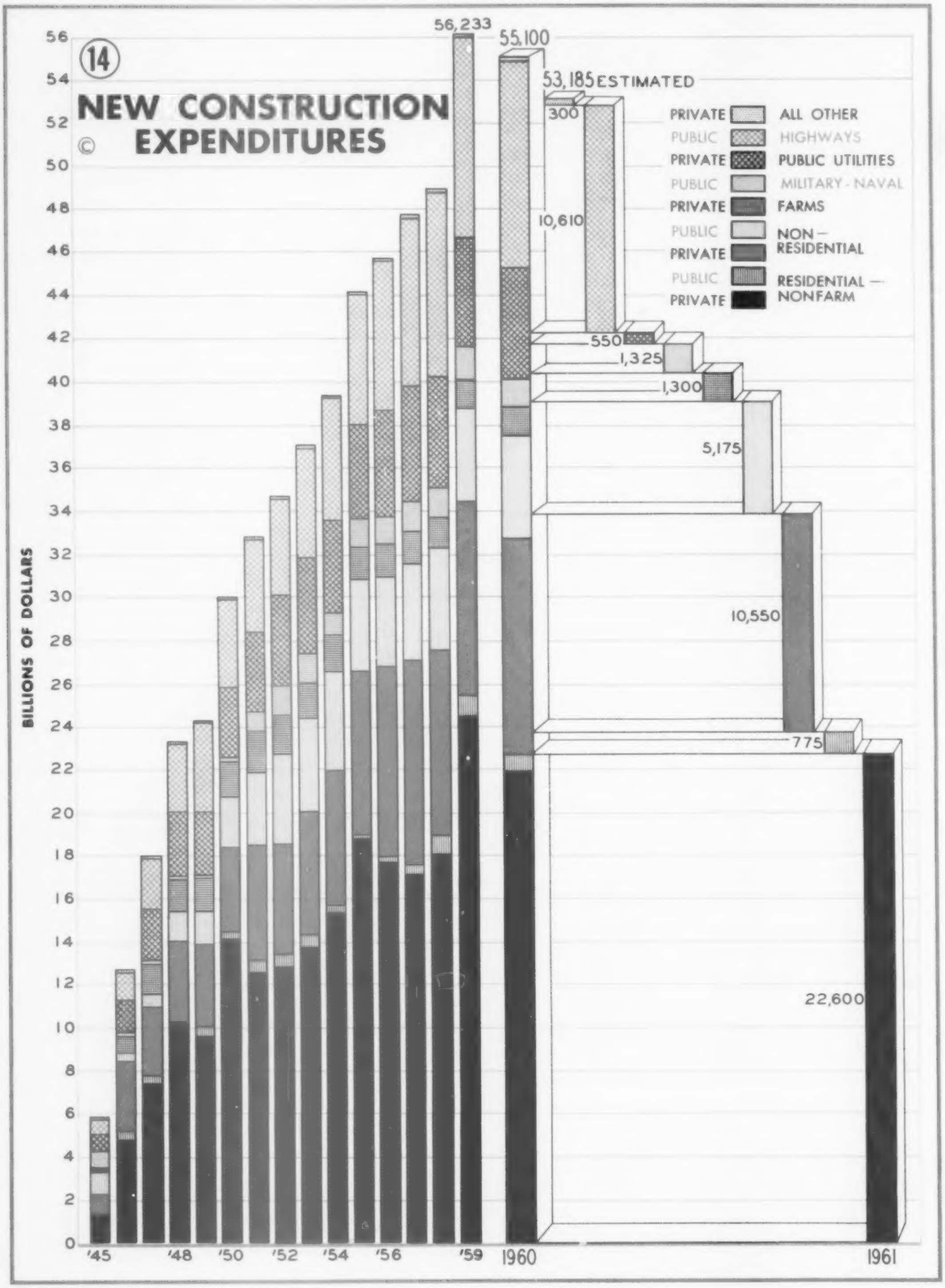


Chart 15 shows expenditures for plant and equipment in comparison with anticipated expenditures. It will be noticed that the anticipated line on the chart is sufficiently close to the actual that it can be used roughly for forecasting purposes. I believe that during 1961 expenditures on new plant and equipment will be lower than they were in 1960.

Chart 16 shows a comparison of the fluctuations of office building rents and office building occupancy. The rent figure is complete through 1959; the occupancy figure, through the fall of 1960. Office building rents will continue to increase in 1961, in spite of a further drop in occupancy.

Chart 17 shows the value of all farms in the United States per acre in dollars. The insert chart shows net income to agriculture as a percentage of the value of all farm real estate. This chart would indicate that in 1943 the average farm could be bought for approximately $3\frac{1}{2}$ times its annual net income. Today farms are selling at approximately 11 times their annual net income. While the increase in productivity has been great, it cannot account for this much of a change since 1943. This would indicate to me that farms are currently overvalued in much the same fashion as the stock market.

(cont. on page 22)


14
NEW CONSTRUCTION EXPENDITURES
©
BILLIONS OF DOLLARS
0
2
4
6
8
10
12
14
16
18
20
22
24
26
28
30
32
34
36
38
40
42
44
46
48
50
52
54
56
'45
'48
'50
'52
'54
'56
'59
1960
1961
56,233
55,100
53,185 ESTIMATED
300
10,610
550
1,325
1,300
5,175
10,550
775
22,600
PRIVATE ALL OTHER
PUBLIC HIGHWAYS
PRIVATE PUBLIC UTILITIES
PUBLIC MILITARY-NAVAL
PRIVATE FARMS
PUBLIC
PRIVATE
NON-RESIDENTIAL
PUBLIC
PRIVATE
RESIDENTIAL — NONFARM

NEW CONSTRUCTION IN THE UNITED STATES
1960 and Outlook for 1961 (Millions of dollars)

Estimates of the Department of Commerce

Type of Construction	1960	1961	% change
TOTAL NEW CONSTRUCTION	55,100	57,300	+4
PRIVATE CONSTRUCTION	38,900	40,250	+3
Residential buildings (nonfarm)	21,950	22,600	+3
New dwelling units	16,300	16,750	+3
Additions and alterations	4,750	4,850	+2
Nonhousekeeping	900	1,000	+11
Nonresidential buildings (nonfarm)	10,075	10,550	+5
Industrial	2,900	3,100	+7
Commercial	4,050	4,150	+2
Office buildings and warehouses	2,050	2,250	+10
Stores, restaurants and garages	2,000	1,900	-5
Other nonresidential buildings	3,125	3,300	+6
Religious	1,045	1,075	+3
Educational	590	650	+10
Hospital and institutional	575	625	+9
Social and recreational	675	700	+4
Miscellaneous	240	250	+4
Farm construction	1,300	1,300	0
Public utilities	5,275	5,500	+4
Railroad	300	275	-8
Telephone and telegraph	1,100	1,050	-5
Electric light and power	2,050	2,050	0
Gas	1,700	2,000	+18
Other public utilities	125	125	0
All other private	300	300	0
PUBLIC CONSTRUCTION	16,200	17,050	+5
Residential buildings	725	775	+7
Nonresidential buildings	4,800	5,175	+8
Industrial	400	400	0
Educational	2,875	3,100	+8
Hospital and institutional	400	425	+6
Administrative and service	615	700	+14
Other nonresidential buildings	510	550	+8
Military facilities	1,325	1,325	0
Highways	5,700	6,000	+5
Sewer and water systems	1,500	1,525	+2
Public service enterprises	650	650	0
Conservation and development	1,275	1,350	+6
All other public	225	250	+11

CONCLUSIONS

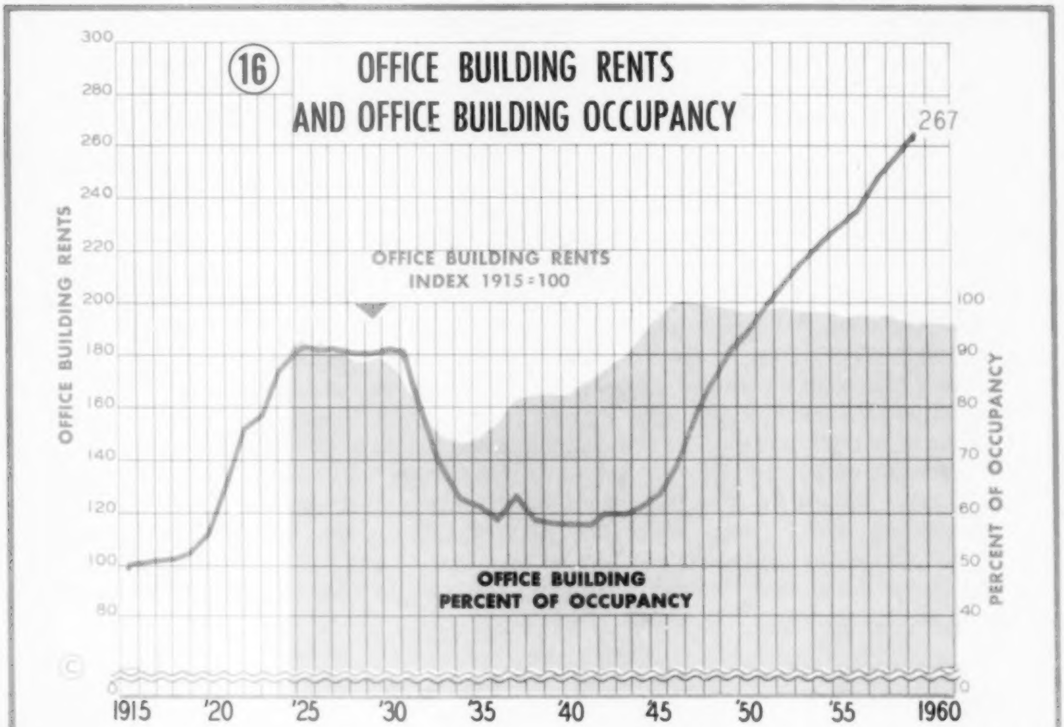
In a free economy not every year can set a record. Progress is never a straight line. It is necessary from time to time to pause and correct the mistakes which have been made. If these mistakes have been deep-seated and long-continued, like the inflationary policies which have caused our gold crisis, it takes longer to make the adjustment.

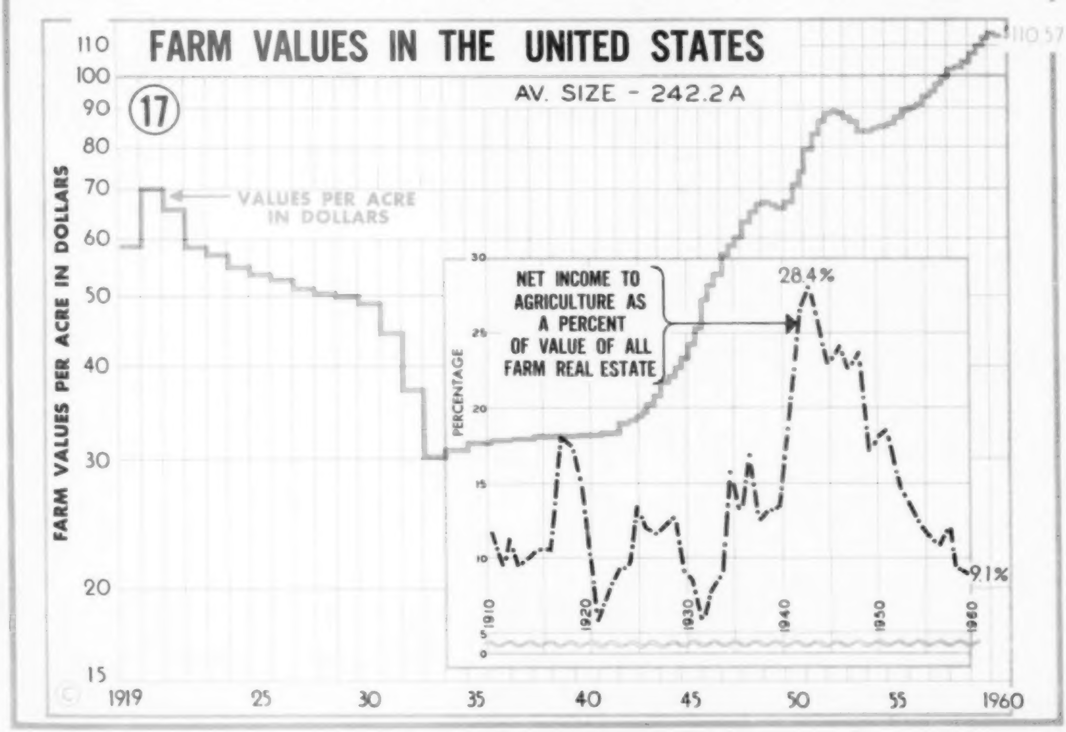
The best solution for an inflationary binge is not more inflation. The austerity program which will correct the excesses is never popular. Neither is it painless. It always causes some suffering. So does filling a decayed tooth or operating to remove a malignant growth. The temporary discomfort can be endured to correct a condition which cannot be allowed to continue.

In my opinion, 1961 will continue the readjustments in the economy which started in 1960. Unfortunately, neither new construction nor the production of automobiles can be counted on to go forward at a rate sufficiently rapid to spark a sudden recovery.

If I am right, the stock market is still too high, and if it should drop to a more rational level, the erasing of paper profits would probably be a tremendous shock to confidence and would not help the general business situation at the time.

(cont. on page 24)


16
OFFICE BUILDING RENTS
AND OFFICE BUILDING OCCUPANCY
OFFICE BUILDING RENTS
INDEX 1915=100
OFFICE BUILDING
PERCENT OF OCCUPANCY
OFFICE BUILDING RENTS
PERCENT OF OCCUPANCY
267
1915
'20
'25
'30
'35
'40
'45
'50
'55
1960


FARM VALUES IN THE UNITED STATES
17
AV. SIZE - 242.2 A
FARM VALUES PER ACRE IN DOLLARS
VALUES PER ACRE
IN DOLLARS
NET INCOME TO
AGRICULTURE AS
A PERCENT
OF VALUE OF ALL
FARM REAL ESTATE
PERCENTAGE
28.4%
9.1%
110.57
1919
25
30
35
40
45
50
55
1960

While I think that new private building will be off, road and bridge construction will exceed a year ago. Alterations and repairs on existing private buildings will, I believe, exceed a year ago by a considerable percentage.

While I consider improved urban real estate to be less inflated than other types of investments, we are still faced with the fact that the long-term cycle chart on real estate activity computed by our company would indicate that if the future is to follow even in a rough fashion the patterns of the past, some additional readjustment is still ahead of us. I think this readjustment will be relatively mild and will not be accompanied by a high level of foreclosures. I think that labor rates in the construction field will continue up, as many contracts already in existence provide for increases at specific times. This will not increase construction costs by a large percentage, however, as every contractor in a period of lower volume discards his less efficient help. This increases the output per hour of the remaining force and reduces the spoilage of material. This I think will prevent construction costs on a typical residence from rising, but I also believe that no great drops can be expected in these costs. Since over the long period the values of existing buildings depend largely on their replacement cost new, this should be a stabilizing factor for the values of existing properties.

While 1961 will not be one of our best years, it will still be a year which in total real estate activity, construction volume, and other related factors will exceed all but a relatively small number of years in the past.

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